



Statement of the Chamber of Commerce of the United States

ON: CIVIL SERVICE PENSION REFORM

TO: SENATE GOVERNMENTAL AFFAIRS COMMITTEE

BY: JOHN N. ERLNBORN

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The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The Chamber of Commerce of the United States is the world's largest federation of companies and associations and is the principal spokesman for the American business community. It represents more than 180,000 companies plus several thousand other organizations such as local/state chambers of commerce and trade/professional associations.

More than 90 percent of the Chamber's members are small business firms with fewer than 100 employees, 53 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business--manufacturing, retailing, services, construction, wholesaling, and finance--numbers more than 14,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 53 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

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Mr. Chairman and members of the Committee, my name is John N. Erlenborn and I am a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson. I am pleased to appear here today on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce and trade and professional associations. Accompanying me today is James A. Klein, Manager of Pension and Employee Benefits for the Chamber.

I serve on the Chamber's Labor and Employee Benefits Committee and on several of that Committee's councils and task forces which develop policy on labor and employee benefits matters.

As you may know, during my 20 years in the House of Representatives, I took a keen interest in developing a rational retirement policy for both the public and private sectors. That interest and involvement have continued since my retirement in January to practice law as a specialist in employee benefit issues. Because of my long-standing interest and involvement in these matters, it is a particular pleasure to share with you our perspective on reform of the Civil Service Retirement System (CSRS). Congress has quite a challenge before it to enact by the end of this year a new retirement system for federal employees hired after 1983.

Senator Stevens and Senator Roth are both to be commended for developing a comprehensive and thoughtful bill, S. 1527 (the "Stevens/Roth plan"). This bill seeks to address the important questions that should be decided by year-end in order to keep post-1983 federal hirees from remaining in limbo regarding their retirement program. While it is important for Congress to act expeditiously, it also is crucial to develop a system that balances the need of federal workers to be ensured adequate retirement coverage and the need of taxpayers to pay for an equitable and reasonably priced system.

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We wish to share our thoughts on the Stevens/Roth plan and on the development of a new retirement system for recently-hired workers within the context of reform of the CSRS. At the outset, I should state that the center of the Chamber's position on the federal retirement system is the concept that it should be modified to approximate more closely its private-sector counterpart.

As a leading supporter of the private pension system and a principal author of ERISA, the Employee Retirement Income Security Act of 1974, I believe much can be learned from the private system for constructing a reasonable and financially sound federal retirement structure. In at least two respects -- cost-of-living adjustments (COLAs) and early retirement -- the CSRS differs substantially from the private sector retirement system. These are the two issues upon which my remarks will mainly focus.

In large part due to the COLA and early retirement features of the CSRS, most federal retirees receive more generous benefits than those received by most private sector retirees whose tax dollars substantially support the federal retirement system.

Cost-of-Living Adjustments (COLAs)

COLAs were first authorized for federal pensions in 1962. The original civil service pension COLA was triggered when inflation exceeded three percent. Since 1962, the federal pension COLA has been on a veritable roller coaster.

The COLAs in the federal retirement system have been indexed fully to increases in the Consumer Price Index (CPI) since 1966. By contrast, the private pension system does not match these cost-of-living increases. In the private sector, a defined benefit pension plan provides exactly what its name suggests--a definite benefit amount--frequently with no adjustments for inflation. Some private plans do contain inflation adjustments, and other companies increase benefits voluntarily. Social Security also adjusts for inflation. However, a U.S. Department of Labor survey indicated that in 1982 only three percent of all private plans contained automatic inflation adjustments. Moreover, these adjustments were limited generally to three percent per year, rather than the open-ended adjustment that the federal government pays its retirees.

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There is no question that basic benefits should be increased during periods of inflation, but retired persons should not receive greater cost-of-living protection than working people. Yet, that is what has happened and will happen again this coming year as federal pay is frozen and pension benefits rise.

In 10 of the years from 1971-1983, persons drawing federal retirement benefits received larger annual increases than wage earners gained in union negotiations in private industry. While these working Americans realized an average annual gain of 60 percent of the CPI increases in their paychecks, the retired federal worker gained 100%.

The full CPI adjustments paid to federal pensioners also result in the anomalous situation that some retirees can receive more in annual federal retiree benefits than the salaries earned by the individuals filling the positions formerly held by the retirees. We must restore economic equity between working and nonworking generations.

How then should Congress deal with COLAs, which in large part are responsible for the explosive growth in spending on all federal pensions from \$2.7 billion in Fiscal Year 1970 to over \$23 billion this year? One way might be to consider something akin to the "COLA Stabilizer" which I proposed in the FAIR (Federal Annuity and Investment Reform) civil service retirement legislation I introduced in the 98th Congress. This proposal bases the COLA on the lesser of the increase in the general schedule increase or the CPI. This reference amount is then applied to the first \$10,000 of pension, an amount roughly equal to the maximum benefit a new social security recipient would receive in 1985. A more limited COLA adjustment is then granted on pension amounts above \$10,000.

Another alternative is indicated in the Stevens/Roth plan whereby annual COLAs would be paid at two percent below the rate of inflation as measured by the CPI.

It should be noted that either proposal would help achieve the goal of bringing federal employees to the level of private-sector employees. Even with these changes from the current CSRS, however, federal retirees would have a more generous retirement plan than is found in the private sector. For most private sector retirees, Social Security COLAs are the only inflation adjuster built into the retirement income formula. Benefit increases in private sector plans are typically on an ad hoc basis, depending largely on the available funds in the plan. Many private sector retirees have no private pension coverage at all.

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It is important when considering a COLA as part of the new federal retirement system, to compare the system with prevailing practices in the private sector -- not with the current CSRS -- because the participants of the new system will, like their private sector counterparts and unlike federal employees hired prior to 1984, have Social Security COLA protection.

Early Retirement

The provision of the CSRS that permits an unreduced annuity for federal employees retiring at age 55 after 30 years of service often has been in the eye of the storm of controversy surrounding federal pensions. Therefore, an explanation of the early retirement features of private pension systems is in order to develop a workable and fair early retirement feature.

In the private pension system, early retirement is more commonly available at age 62 than at age 55, and even then, the retirement benefit generally is reduced for each year the retiree is under age 65. This also is the case with Social Security benefits.

No one can argue reasonably that individuals who have worked hard and who have looked forward to the comfort and security of retirement years should be denied the benefits they have earned. However, the only adequate explanation for the discrepancy in retirement ages between federal and non-federal retirees is that the availability of full benefits at age 55 is a powerful incentive for federal employees to retire at this early age. This practice denies the federal government the services of some of its most capable and experienced workers and requires the taxpayers to subsidize pensions for lengthy periods.

Phasing-in reduced benefits for retirees between the ages of 55 and 65 would bring the federal retirement system into closer alignment with private sector retirement practices. The Chamber supports this reform and urges the Congress to do likewise.

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At this point a discussion of some of the myths and facts of retirement age in the federal sector is in order so that the early retirement features may be understood better and put into proper perspective. Some dismiss the matter of early retirement as inconsequential since they believe that federal employees retire at close to the retiring age of private sector workers. The Federal Government Service Task Force, a congressional caucus, claimed in a Fall 1984 report that "both private and federal workers retire, on average, at age 61." The Task Force quoted Office of Personnel Management (OPM) figures showing that in 1982 CSRS retirees on the average left at age 60.7 with 28 years of service.

Unfortunately, these figures do not tell the entire story. But let us not lose sight of the forest by looking at the trees, debating statistics when the policy of unreduced early pensions is the problem. If the policy of early retirement is a privilege paid-for mainly by taxpayers and yet not enjoyed by them, then where is the equity in continuing that policy? Indeed, if federal retirees retire later than assumed, why oppose change?

For the record, certain points should be made about the retirement age issue. First, the Bureau of Labor Statistics' Office of Employment and Unemployment Statistics does not collect data on average private sector retirement ages due to definitional problems (for example, is a rehired annuitant retired?), thus, there is no reliable private sector average retirement age data published by the government.

Secondly, let us beware of averages that mask significant data. The average age of retiring federal employees from 1973 to 1982 was 61.1 years, according to Table 15 on page 31 of the Congressional Research Service (CRS) report, "Background on the Civil Service Retirement System." What this Table does not state is that, according to OPM, about 39% of retiring federal employees retire within one year of attaining age 55 with at least 30 years of service.

Further, the 61.1 age refers only to optional retirement (those with age/service of 55/30, 60/20, and 62/5). It does not include retirement ages for disability, involuntary, deferred, mandatory, or special retirement situations (hazardous, Member of Congress, etc.).

The figure quoted by the Task Force is only for optional retirement. It represents 69.3% of the 85,000 retirees in 1982. As a matter of fact, 25% of the 1982 CSRS retirees left federal service at an average age of 52.

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The question again, arises, how best do we correct the early retirement features of the civil service retirement system?

Both my FAIR proposal of the 98th Congress and S. 1527 are directed at bringing the early retirement features of a new federal system into closer conformity with private-sector practices.

Under my FAIR proposal, current employees as well as future employees would be able to retire under the same age-service provisions as under present law, but the amount of benefits based on service after the year of enactment would be subject to a reduction factor of two percent for each year under normal retirement age. The two percent rule would not reduce the amount of an employee's benefit which is accrued prior to the year of enactment. This change in the value of future benefits not yet earned is permissible under the law governing private pensions (ERISA) and responds to the arguments that changing the method of calculating benefits violates an implied contract between federal workers and their employer.

The Stevens/Roth plan also reduces an annuity for early retirement -- reducing benefits for retirement before age 62. Earlier this year the Reagan Administration also proposed a phase-in of reduced benefits for retirees between the ages of 55 and 65.

I am not suggesting that the reduction factor must be two percent as it was proposed in the FAIR legislation. I am suggesting that some reduction factor be considered. Social Security reduces benefits by 6-2/3% for every year under age 65. CRS reports, on page 42 of its December 1984 study for the House Post Office and Civil Service Committee, that a full actuarial reduction would reduce payments by six or seven percent per year. However, private pension plans often reduce employees' accrued pension benefits by about four or five percent a year if they retire early.

Employees should not be prevented from retiring early, but neither should they be encouraged to leave early by an excessively generous provision. I believe that a proposal to moderate early retirement costs will work to the benefit of our government and its employees.

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Additional Components of a New Retirement System

As the Committee considers the Stevens/Roth plan and the development of a new civil service retirement system, there are a number of features of the system apart from COLAs and early retirement that need to be determined. Consistent with our policy, the Chamber believes that those features should approximate common features of private sector as much as possible.

In 1983, this Committee and the House Post Office and Civil Service Committee asked the U.S. General Accounting Office (GAO) to analyze information on prevailing features of retirement programs in the nonfederal-sector. In June 1984, GAO published its exhaustive study entitled Features of Nonfederal Retirement Programs.

The GAO report used the Department of Labor's Bureau of Labor Statistics' 1982 study entitled "Employee Benefits in Medium and Large Firms." This study involved 976 pension plans covering 17 million participants. GAO also used extensive surveys conducted by four private firms and by the National Association of State Retirement Plan Administrators.

The GAO report determined that retirement programs in the nonfederal-sector, where they exist, typically involve Social Security, a pension plan and a capital accumulation plan such as a thrift or deferred compensation plan. Within these broad components, specific features of private plans commonly are found. I would like to enumerate some of these items.

Normal Cost

The employer cost of the current CSRS is an unacceptably high percentage of the total federal payroll. CRS estimates the cost at 25% of pay. An independent study conducted for OPM found the cost to be 28% of payroll, as did the study by the President's "Private Sector Survey on Cost Control" (Grace Commission).

In the private sector, however, the employer costs are much less. The same study prepared for OPM, mentioned above, found that private pension costs were 18% of pay, while the Grace Commission placed the figure at 17%. These studies looked at the norms in medium and large companies that have pension

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plans. Other estimates, including the U.S. Chamber's annual Employee Benefits Survey and the U.S. Department of Commerce's Survey of Current Business, both of which look at the entire spectrum of business sizes across the economy, including those with and without pension plans, revealed the cost of retirement plans at between four and five percent of payroll.

The point is clear. By any measure, the cost of the present federal retirement system is inordinately high. The new system must seek to bring the normal cost of the retirement plan into accord with normal costs in the private-sector as a matter of fiscal responsibility toward the taxpayers who support the system, as a matter of equity between federal and nonfederal workers, and as a matter of honesty toward the federal employees who are relying upon the ability of the government to pay the benefits they are being promised.

Social Security Integration

The Social Security system replaces a higher proportion of earnings for people with lower average wages. The U.S. Chamber supports this "tilt" as a form of social insurance for lower-income earners. Because of this tilt, many pension plans are "integrated" with Social Security, in that a portion of the Social Security benefits is deducted from the benefits the pension plan would otherwise pay under its benefits formula. This deduction tends to equalize the proportional wage replacement among higher- and lower-paid workers when pension benefits and Social Security benefits are combined.

The GAO report found, among the surveys it used to compile its report, that between 64% and 96% of private-sector plans were integrated with Social Security. The degree to which the Social Security tilt is offset and the method by which it is done vary among different pension plans. However, the extensive data compiled by the studies which GAO analyzed clearly suggest that the integration of Social Security and pension benefits is the predominant practice in the private sector. To the extent that the new system is not integrated with Social Security, it is departing from the typical private-sector practice.

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Employee Contributions

Federal employees covered by the current CSRS are required to contribute to their pension plan. According to GAO data, this is clearly contrary to the common practice in the private sector, where between 78% and 93% of the pension plans are fully paid by the employer.

Employer sponsorship, however, does not preclude the opportunity for voluntary employee contributions. As discussed above, capital accumulation plans are a typical feature of comprehensive retirement programs in the private sector. Whether it is in the form of a salary-reduction 401(k) plan, a thrift plan or other type of capital accumulation plan, the new system should encourage employees who can afford to do so to help save for their retirement. This will provide federal employees the same opportunity which many private-sector employees enjoy -- to contribute toward their retirement income security -- and will discourage the financial pressure on the federal government in determining its proper level of contributions.

The Stevens/Roth plan, by not requiring employee contributions to the defined benefit plan but by establishing a voluntary capital accumulation plan, resembles common features of private-sector retirement programs.

Vesting

In the CSRS, employees are vested after five years. The GAO report demonstrates that an overwhelming number of private-sector pension plans provide for "cliff" vesting after 10 years. A small percentage of plans provide for either "cliff" vesting after a period other than 10 years or graduated vesting. The Committee should be aware that the five year vesting feature of the defined benefit portion of the Stevens/Roth plan is not the prevalent practice in the private sector. In the absence of any evidence showing that vesting rules should differ for the private sector and the federal government, the new federal system should align itself more closely with the typical private practice.

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CONCLUSION

Our Nation's private-sector pension system provides an ideal model for Congress to use in developing a pension system for newly hired federal employees. The mandatory inclusion of federal employees in the Social Security system places them in the same position as private-sector employees and adds further credence to the notion that a private-sector type of retirement program should be developed.

Several features of the Stevens/Roth plan resemble common features of private-sector retirement plans. The Chamber notes and appreciates that fact. In other respects, the Chamber notes that features of the proposal differ from common industry practices and encourages the Committee to bring the bill closer to conformity with private-sector practices.

Congress has before it a difficult challenge -- but also a unique opportunity -- to fashion a retirement system for newly hired workers. The challenge is to draft a balanced and reasonably-priced system. The opportunity, however, is to create an entirely new system for post-1983 hired federal employees and, by emulating common features of the private-sector system, avoid some of the troublesome aspects of the CSRS. I hope my comments will assist you in meeting this challenge and opportunity.